



Calhoun: The NPS Institutional Archive

Faculty and Researcher Publications

Faculty and Researcher Publications

2007

Book Review: The Age of Turbulence: Adventures in a New World written by Alan Greenspan

Looney, Robert

Gulf Research Center



Calhoun is a project of the Dudley Knox Library at NPS, furthering the precepts and goals of open government and government transparency. All information contained herein has been approved for release by the NPS Public Affairs Officer.

Dudley Knox Library / Naval Postgraduate School
411 Dyer Road / 1 University Circle
Monterey, California USA 93943

<http://www.nps.edu/library>



The Age of Turbulence: Adventures in a New World

Author: Alan Greenspan

Publisher: The Penguin Press, 2007

Reviewed by Dr: Robert Looney
Professor, Naval Postgraduate School, US

Alan Greenspan was appointed chairman of the Board of Governors of the US Federal Reserve on August 11, 1987. For most of his 18 years at the Fed he was widely regarded as the infallible oracle of economic policy. True to its origins, during this period the Fed remained a somewhat secretive or at least opaque organization. However, with the publication of *The Age of Turbulence: Adventures in a New World*, outsiders are provided with a glimpse of the Fed's inner workings, its economic theories and, most importantly, the underlying philosophies upon which major decisions were based.

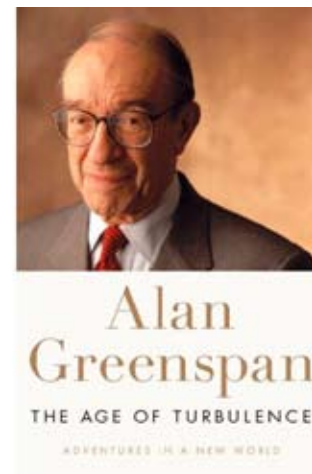
The common image of Alan Greenspan is a brilliant but rather cryptic man, who, as the world's most important central banker, developed convoluted, ambiguous language into an art form. As legend has it, when a listener to one of his speeches began a question by saying "If I have understood you clearly, Mr. Chairman," Greenspan answered wryly that if the listener had understood him clearly then he (Greenspan) hadn't been doing his job properly. Perhaps for this reason, *The Age*

of Turbulence was ghost written by Peter Petre (who also wrote the autobiographies of Gen. H. Norman

Schwartzkopf and IBM head Thomas J. Watson Jr.). To his credit, Petre has risen to the challenge of translating a potentially dry treatise full of arcane "Fed Speak" and "Greenspanese" into something rather enjoyable even for the uninitiated.

Greenspan's timing of his memoirs, like many of his policies, couldn't have been more opportune – they appeared just when interest in financial turbulence brought on by the sub-prime lending crisis was approaching a zenith. Within several weeks of its release, the book topped the New York Times best-seller list. No doubt this was a great relief for his publisher who reportedly paid \$8 million for the publication rights.

The Age of Turbulence is divided into three main parts – each with a somewhat different tone and aimed at a slightly different audience. The first



part is largely personal starting with Greenspan's early boyhood years in New York City. Here many readers will no doubt be surprised to learn that his early ambitions were to be a professional baseball player followed by hopes of a music career – a professional-caliber jazz clarinetist. Also included are fascinating accounts from his later years as an economic consultant/forecaster and as an advisor to Presidents Nixon, Ford, Reagan, George Walker Bush, Clinton, and the current president Bush. He hands out grades – Nixon the crudest, Ford the most decent, and Clinton the smartest.

The second part provides Greenspan's view of the world – how his economic framework evolved to address the challenges of an increasingly globalized world with its rapidly evolving financial markets. Here we learn the two big influences on his thinking and approach to policy were economist Joseph Schumpeter, who thought 'creative destruction' was the lifeblood of market capitalism, and libertarian Ayn Rand from whom he derived his over-riding preference for free, unregulated markets.

The third part – Greenspan's account of public policy – will be of most interest to many. Certainly it is most often quoted in the media. A life-long Republican himself, Greenspan criticizes President George W. Bush, Vice President Dick Cheney and the Republican Party-controlled Congress for abandoning the Republican Party's traditional tenets of fiscal discipline. Greenspan's criticisms of President Bush include his refusal to veto new Federal legislation, thus increasing spending with unprecedented ease. In Greenspan's opinion, Bush's approach to dealing with the Congress has been one of "conflict avoidance", and fulfilling political promises/agendas with little room for compromise or reason. "They swapped principle for power. They ended up with neither. They deserved to lose the 2006 election."

For the professional economist and Fed watchers, perhaps the most intriguing sections are those in which Greenspan mounts a defense of

his tenure as Fed chief. Critics have leveled four specific charges against his policy reign: (1) that he should not have, but did, support the Bush tax cut of 2001; (2) that he should not have, but did, encourage new US homeowners to get adjustable-rate mortgages in the early 2000s; (3) that he should have done something to abort the dot-com bubble of the late 1990s; and (4) that he should have done something to prevent the real estate bubble of the 2000s.

Greenspan's defense on the tax cut is compelling – his support for this measure was conditional on the assumption of budget checks and spending restraints to be put in place to prevent budget deficits. The media by overlooking these caveats misinterpreted his position for a blanket endorsement. As for the second charge, he admits that he did not properly understand in the early 2000s the big effect low interest rates and prepayment penalties would have in luring new and financially strapped homeowners into deals that were not in their best interest.

With the first two charges disposed of, he appears to stumble a bit on the final two. He notes that given the state of investor psychology, he could have aborted the stock market and housing bubbles of the late 1990s and the early 2000s but only by paying an unacceptable price in idled factories and unemployed workers. This is a bit inconsistent with his argument at the time that fast productivity growth and the flexibility of the American economy meant that risks could be taken with inflation. In any case, the record shows he always chose to err on the side of low interest rates and loose monetary policy.

Here is where Greenspan's uncompromising preference for free market forces may have let him down. As suggested above, under Greenspan a major transformation of monetary policy took place. Prior to 1980, monetary policy was significantly driven by labor market concerns and in many regards worked hand in hand with the other elements of the policy apparatus to put a floor under

labor markets. Under Greenspan monetary policy became increasingly expansionary. At the same time, the financial deregulation process started in the late 1970s resulted in ever more sophisticated financial markets. The Fed responded by shifting its priorities from protecting employment to that of assuring financial values.

The net result of these developments was to weaken the Fed's ability to cope with asset bubbles. Once the equity bubble burst in the late 1990s, the Fed was forced into a post-bubble, liquidity-generating defense that gave rise to one bubble after another. Through a debt-intensive process of equity extraction, this string of bubbles then became the driving force supporting America's excess consumption binge. The result was a record overhang of household sector indebtedness – thereby injecting a new element of systemic risk into the US economy. Saving rates fell forcing the US to draw on surplus saving from abroad, the net result being the unprecedented global imbalances many feel represent an additional element of instability.

Under Greenspan, these developments spawned a new type of business cycle characterized by deindustrialization, overvaluation of the dollar, record trade deficits, widening income inequality and stock market and housing price appreciation that have supported record consumer debt burdens. The foundation of this cycle has been financial booms and cheap imports. The financial boom provides consumers with borrowed finance that

funds spending, while the overvalued dollar and associated cheap imports ameliorate the impact of widening income inequality deindustrialization and periodic bouts of increased income insecurity.

Clearly the process of transformation that took place under his guidance has provided an economic shot in the arm as American households have used their enhanced access to credit to finance increased consumption spending. The open question is what the long-term consequences of this increased financial access will be given the fact the Fed may be losing some control over the process. Specifically the combination of systemic risks and a serious moral hazard dilemma (the temptation of the Fed to bail out financial institutions facing collapse) built up under Greenspan appears to be constraining Fed policy perhaps even to the point of compromising monetary policy. Will the Fed simply let most of the institutions specializing in sub-prime loans just go under or will it be compelled to validate greed and poor business decisions by increasing liquidity even more rapidly to prop them up?

The next few years will reveal whether the mechanisms set in motion by Greenspan's policies are sustainable or whether the whole process will become increasingly vulnerable to collapse brought on by one bubble too many. *The Age of Turbulence* suggests that the system is manageable and can thrive when in the capable hands of someone like Greenspan. Will the same be true of his perhaps less capable successors?